

## Message Text

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ACTION EUR-12

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FM AMEMBASSY BONN

TO SECSTATE WASHDC 4201

INFO AMEMBASSY PARIS

AMEMBASSY LONDON

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C O N F I D E N T I A L SECTION 01 OF 02 BONN 18269

E.O. 11652: GDS

TAGS: EAIR, WB, UK, FR, US

SUBJECT: CIVAIR: IGS FARES

REF: A. BONN 16258 B. USBERLIN 2074 C. STATE 223980

1. SUMMARY: OUR MOST RECENT DISCUSSION WITH BRITISH CAA ON IGS FARES INDICATED THAT EVEN WITH THE ROUTE SWAP BA CALCULATED A SUBSTANTIAL LOSS FOR THE CURRENT YEAR. EMB CAA REPEATED PREVIOUSLY STATED U.S. CONCERNS REGARDING IMPACT ON IGS TRAFFIC VOLUME OF A FARE INCREASE, AND THE LACK OF A JUSTIFIABLE CASE ON THE PART OF PAN AMERICAN. ACCORDING TO GROVES, AIRLINES ARE PRESENTLY RECONCILING FINANCIAL DATA TO TAKE INTO ACCOUNT FORECASTS FOR 1976, AN EXERCISE WHICH SHOULD BE CONCLUDED TOWARD THE END OF THIS MONTH. IF NO PROGRESS MADE ON A FARE INCREASE, GROVES THOUGHT BRITISH MIGHT PRESS FOR DIFFERENTIATED FARES ON BA ROUTES OR POSSIBLY A REOPENING OF THE SUBSIDY QUESTION.

2. AT HIS REQUEST, BRITISH CAA GROVES AND EMB CAA MET RECENTLY TO REVIEW CURRENT SITUATION REGARDING IGS  
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CARRIERS' DESIRE FOR A FARE INCREASE. GROVES UNDERSTOOD

THAT PAA AND BA HAD RECENTLY CONCLUDED CONSULTATIONS WITH LITTLE CONCRETE RESULTS EXCEPT THAT BOTH CARRIERS AGREED TO UPDATE THEIR FINANCIAL DATA TO INCLUDE 1976 FORECASTS. ALTHOUGH AWARE THAT U.S. HAD DIFFICULTY IN PROCEEDING ON THE BASIS OF PAA'S FAVORABLE FINANCIAL RESULTS, BRITISH FELT STRONGLY THAT SOME MOVEMENT HAD TO TAKE PLACE SOON BECAUSE OF BA'S PRESSING REQUIREMENTS. ON THE BASIS OF 1974-75 DATA -- REVISED TO TAKE INTO ACCOUNT THE JUNE 1 ROUTE DIVISION -- BA STILL CALCULATED A LOSS ON THE ORDER OF ONE MILLION POUNDS THIS CALENDAR YEAR. GROVES POINTED OUT THAT THE SITUATION WAS MADE EVEN WORSE BY THE FACT BA HAD NOT FULLY RECOUPED 1974 LOSSES RESULTING FROM FUEL COST INCREASES.

3. RECENT SIGNALS FROM LONDON SUGGEST THAT THE UK DEPARTMENT OF TRADE (DOT) FELT THAT BA'S POSITION WILL DETERIORATE EVEN FURTHER AS FUEL SUPPLIERS BEGIN TO PASS ALONG THE RECENT OIL PRICE INCREASE. FOR THIS REASON DOT IS CONSIDERING PRESSING FOR A LARGER FARE INCREASE THAN THE AIRLINES REQUESTED LAST FALL -- A TOTAL OF ABOUT TEN PERCENT. ACCORDING TO GROVES, LONDON BELIEVES LUFTHANSA'S NOVEMBER 9.6 PERCENT FARE INCREASE WOULD PROVIDE THE ALLIES WITH A STRONG ARGUMENT FOR PROCEEDING ON IGS FARES. GROVES OPINED THAT IF THE U.S. COULD NOT AGREE ON THE MATTER THE UK WOULD COME UNDER PRESSURE TO APPLY SELECTED FARE INCREASES ON BA ROUTES. REGARDING SUBSIDIES, GROVES SAID NEITHER BA NOR THE UKG WERE PARTICULARLY SANGUINE THAT THE GERMANS WOULD BE RECEPTIVE. NONETHELESS, LONDON WAS ALSO GIVING SOME THOUGHT TO THIS ALTERNATIVE, BUT WITHOUT DOUBT A PROMPT FARE INCREASE REMAINED THE PRINCIPLE OBJECTIVE.

4. EMB CAA SAID THAT WE WELCOMED AN EXCHANGE OF VIEWS BUT SINCE PAA WAS IN THE PROCESS OF REVISING ITS DATA, THERE WAS LITTLE CONCRETE WE COULD SAY AT THIS JUNCTURE. WE FELT STRONGLY, HOWEVER, THAT CONSIDERATION OF ANY UPWARD ADJUSTMENT IN IGS FARES SHOULD TAKE FULL ACCOUNT OF THE SUBSTANTIALLY IMPROVED SEAT FACTORS BOTH CARRIERS WERE CURRENTLY ENJOYING AS A RESULT OF THE ROUTE DIVISION.

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IT SEEMED TO US THAT IT WOULD BE EXCEEDINGLY ILL-ADVISED TO RISK TRIGGERING AN ACCELERATED DOWNWARD SPIRAL IN TRAFFIC VOLUME BY INCREASING FARES AT THIS PARTICULARLY SENSITIVE JUNCTURE IN IGS DEVELOPMENT. IN THIS CONTEXT PAA EXPERTS HAVE TOLD US THAT DEMAND ELASTICITY INCREASES MARKEDLY AS FARES RISE, THUS WE WOULD EXPECT THE IMPACT OF THE NEXT FARE INCREASE TO BE EVEN MORE DAMAGING TO PASSENGER LEVELS THAN PRECEDING ONES.

5. EMB CAA ASKED WHETHER CERTAIN BA ACCOUNTING PROCEDURES  
SUCH AS THE REQUIREMENT TO INCLUDE AN ENTRY FOR EQUIPMENT

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REPLACEMENT COSTS, MIGHT NOT BE OVERSTATING BA'S LOSSES.  
GROVES SAID THIS MIGHT INDEED EXPLAIN TO SOME EXTENT  
THE SCOPE OF THE DIFFERENCE IN OPERATING RESULTS OF  
THE TWO CARRIERS AND ADMITTED IT MIGHT BE WORTH PURSUING  
THIS FURTHER. HE DOUBTED, HOWEVER, THIS APPROACH WOULD  
ALTER BRITISH VIEWS MATERIALLY.

6. GROVES INFORMED US SUBSEQUENTLY HE HAD LEARNED FROM  
LONDON THAT BA AND PAA HAD AGREED TO DEVELOP A COMBINED  
FINANCIAL SUBMISSION, RECONCILING THEIR DIFFERING  
ACCOUNTING METHODS. EMB CAA REMINDED GROVES THAT WE  
HAD SERIOUS RESERVATIONS ABOUT THE JUSTIFICATION FOR  
AN INDUSTRY APPROACH IN VIEW OF THE ROUTE DIVISION.  
WE NONETHELESS SAW SOME MERIT TO SUCH AN EXERCISE SINCE  
WE COULD GAIN A MORE ACCURATE FINANCIAL PICTURE OF THE  
IGS THAN WE HAVE ACHIEVED IN THE PAST BY AVERAGING TWO  
SETS OF OPERATING RESULTS, WHICH WERE ARRIVED AT BY  
DIFFERING ACCOUNTING PERIODS AND METHODOLOGY.

(MOREOVER, WE MIGHT BE ABLE TO RESOLVE ANY DISTORTIONS RESULTING FROM THE ACCOUNTING ANOMALIES MENTIONED IN PARA 4 ABOVE.) GROVES UNDERSTOOD THAT PAA/BA RATE EXPERTS WOULD NOT BE MEETING UNTIL NOV. 17; THEREFORE, HE EXPECTED NO FURTHER PRESSURE FROM LONDON UNTIL SOME-  
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TIME AFTER THAT DATE. PAA DIRECTOR RUNNETTE WAS UNABLE TO CONFIRM GROVES' INFORMATION BUT SAID HE WOULD QUERY NEW YORK AND LET US KNOW. WE INDICATED THAT WE WOULD, OF COURSE, WANT PAA'S OWN UP-DATED DATA IN ADDITION TO ANY COMBINED PRESENTATION THAT MIGHT BE WORKED UP TO WHICH RUNNETTE READILY AGREED.

7. COMMENT: WE DO NOT THINK THAT LUFTHANSA'S RECENTLY INTRODUCED FARE INCREASE WOULD NECESSARILY PROVE HELPFUL IN SOLICITING GERMAN SUPPORT FOR A FARE INCREASE. TRANSPORT MINISTRY EXPERTS HAVE LONG MAINTAINED THAT THE IGS AND GERMAN DOMESTIC SERVICES WERE NOT COMPARABLE SINCE LUFTHANSA CARRIED A SUBSTANTIAL NUMBER OF OVERSEAS ORIGIN PASSENGERS, FOR WHOM THE CARRIER DID NOT RECEIVE A FULL FARE. (THIS ARGUMENT IS BASED ON THE FACT THAT ALL DESTINATIONS IN THE FRG ARE COMMON RATED.) TO THE EXTENT POSSIBLE WE WILL LOOK INTO THIS CONTENTION AND ITS IMPLICATIONS FOR LUFTHANSA'S YIELD FOR POSSIBLE FUTURE USE. THE KEY ECONOMIC ISSUES, OF COURSE, REMAIN THE IGS AIRLINES' REVENUE POSITION AND THE EFFECT A FARE INCREASE WOULD HAVE ON NEAR-TERM IGS TRAFFIC VOLUME.

8. THE ABOVE WAS DRAFTED BEFORE RECEIPT OF STATE 261821. A QUICK CHECK WITH GROVES (ABOUT TO LEAVE TOWN FOR SEVERAL DAYS) REVEALED THAT HE HAD RECEIVED NO NEW INSTRUCTIONS AS YET. EMB CAA INDICATED OUR WILLINGNESS TO MOVE TOWARD A DECISION AS QUICKLY AS THE AVAILABILITY OF THE NECESSARY DATA PERMITTED. WE AGREED TO MEET AGAIN EARLY NEXT WEEK TO REVIEW BA'S MOST RECENT PARTIAL SUBMISSIONS, ALTHOUGH GROVES ACKNOWLEDGED WE WOULD NOT HAVE SUFFICIENTLY CURRENT MATERIAL ON WHICH TO BASE A USEFUL EVALUATION UNTIL THE AIRLINES COMPLETED THEIR HOMEWORK.  
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